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Imagining Emerging Economies in a Post-COVID World Session III :
Rethinking Monetary System and Debt

Unsustainable International Monetary System and Unsustainable Debt
The Need for Systemic Change

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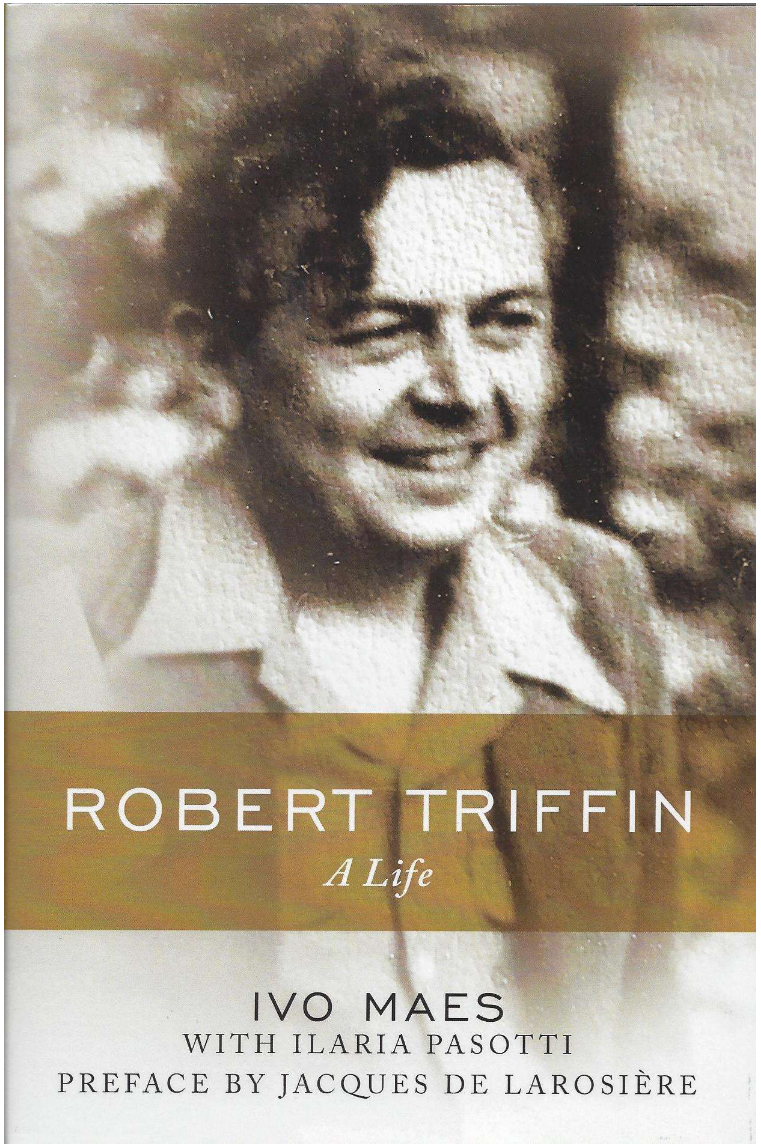


Robert Triffin (1911-1993)

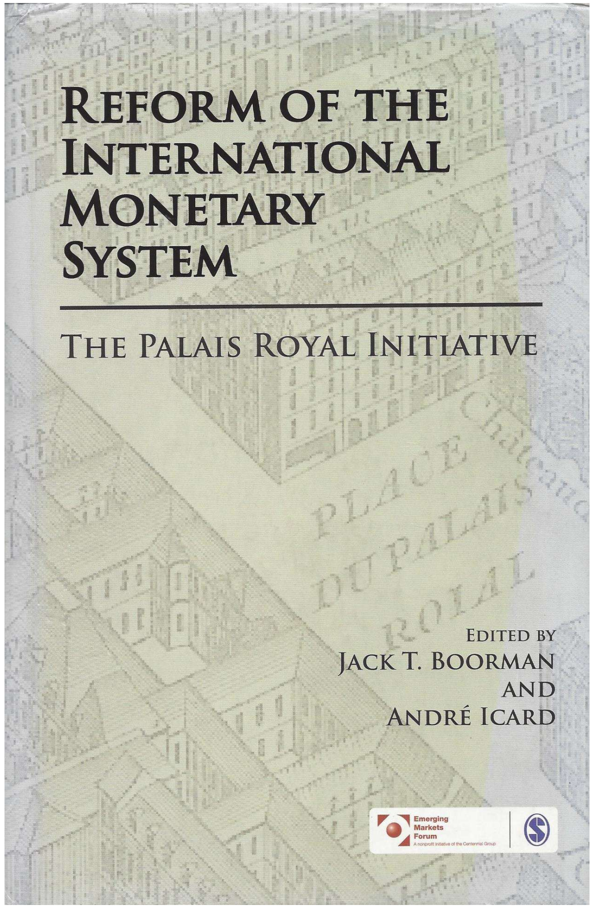
Belgian-American economist, who taught in Harvard, Yale, Louvain, served in IMF, Marshall Plan, Kennedy Administration, European Commission, etc.

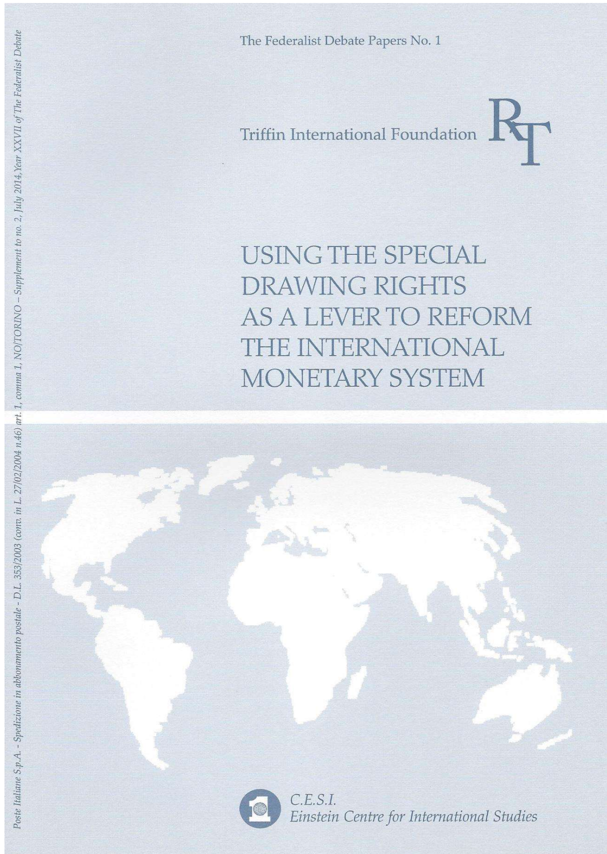
Key contributions to the European Payments Union, the SDR and European Economic and Monetary Integration.

Published « Gold and the Dollar Crisis » in 1960, predicting the collapse of the Bretton Woods System

Enunciated the dilemma : « it is impossible for a national currency used as a world currency to serve properly both the needs of the national economy of the country issuing that currency and the needs of the international economy »
Obvious tendency for the interests of the national economy to prevail over the needs of the global economy, resulting in a continuing risk of excess or shortage of global liquidity.

Robert Triffin International (RTI), created in 2002 in Louvain-la-Neuve (Belgium), under the chairmanship of the late Alexandre Lamfalussy and with the support of Compagnia di San Paolo di Torino, is dedicated to the preservation of Triffin's intellectual heritage.





RTI supported the Palais Royal Initiative of 2010-2011 and promoted its key messages

In complement to the Palais Royal Initiative, RTI created in 2013 a Working Group, under the leadership of André Icard, which made concrete proposals towards enhancing the role of the SDR and using it as a lever to reform the IMS

The evolving manifestations of the Triffin Dilemma

- The Triffin dilemma has not been eliminated by the introduction of floating exchange rates nor by the exponential development of private liquidity. The question of the adequacy of outstanding global liquidity is still with us.
- The Triffin dilemma has become to-day a fiscal dilemma: in a world characterized by huge uncertainties and the absence of a LLR, there is an insatiable appetite for safe assets, the satisfaction of which depends on the constant increase of liabilities issued by the US Treasury : how long will confidence in the dollar be compatible with the illimited expansion of US indebtedness (net external liability of 65% of US GDP or 16. 7 % of world GDP according to Andrew Sheng) .
- « Either the United States will limit its issuance of debt securities, in which case other countries will be starved of international liquidity, or the US government will increase issuance along with foreign demand, in which case confidence in its ability to service that debt, and therefore the safety and liquidity of the latter, will be cast into doubt » (Barry Eichengreen, 2018).
- Jacques de Larosière, former managing Director of the IMF, shares also the view that the Triffin dilemma centers today on the issue of confidence or no confidence in the fiscal capacity of the US, compared to its huge indebtedness. Imbalances continue to mount, undermining the value of the dollar at least in a long term perspective.

The US exorbitant privilege and exorbitant burden

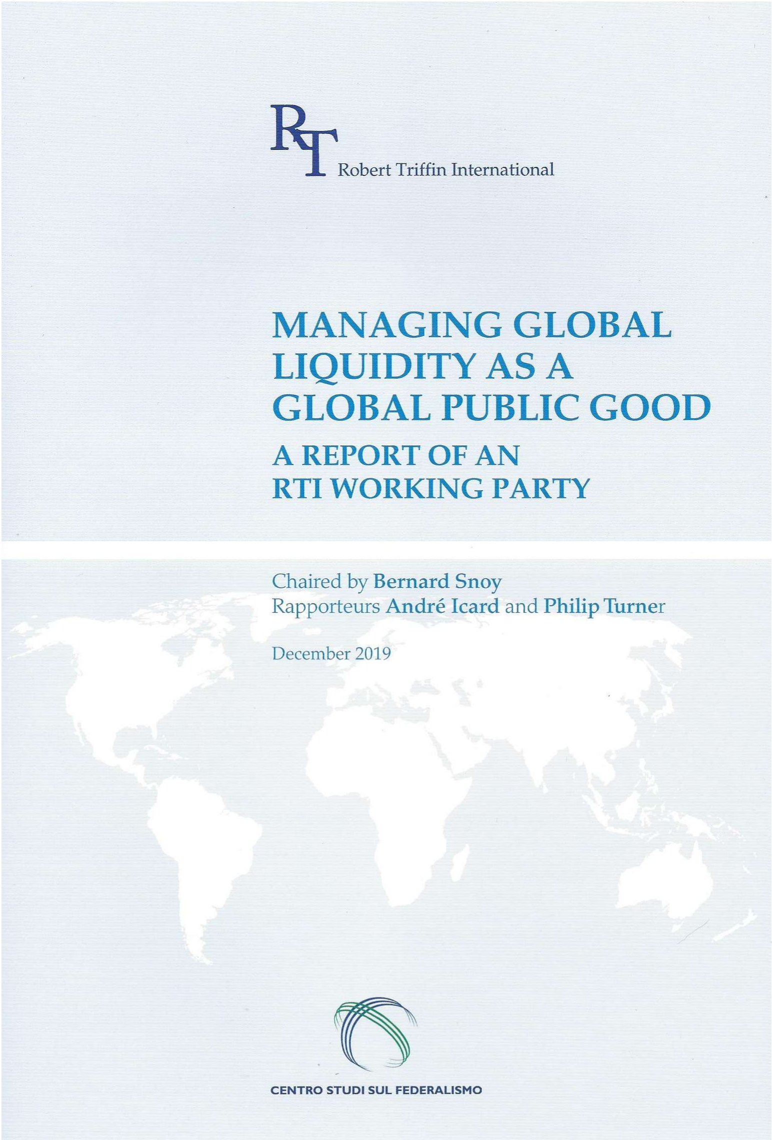
- The use of the dollar as international currency removes the budget and the balance of payments constraint on the US : it is not only allowed but encouraged to live beyond its means (overconsumption and low savings) . This is the « exorbitant privilege » but also the « exorbitant burden » of being the consumer of last resort
- In addition, the massive influx of short term capital into the US economy and resulting capital account surplus pushes the US to overconsumption, drives down US savings, allows the US to play a lucrative international financial transformation function through the difference between a lower cost of borrowing and higher returns on worldwide deployment of US investments. This is again « the exorbitant privilege » of being the « world banker » and the « exorbitant burden » of being the borrower and investor/creditor of last resort. (see Klein & Petit, Trade Wars are Class Wars, 2020).
- The counterpart to the US balance of payments deficit position is the huge accumulation of surpluses in other countries such as China, Germany, the Netherlands and others. There is no mechanism to push these « mercantilist » countries to adjust. The collapse of the Bretton Woods system has removed the anchor to macro-economic discipline. Credit and indebtedness may grow without limit.
- The negative impact of the exorbitant privilege is compounded by the more and more frequent intrumentalisation of the dollar by the US for foreign policy purposes : interdiction of dollar transactions involving Iran, the Northstream Pipeline II, etc.

The « Built-In Destabilizer »

- The use of a national currency as international currency generates what Triffin termed the « built-in destabilizer » through the spillover to the rest of the world of the monetary condition in the US. In particular EME central banks are threatened with destabilizing inflows and outflows of short term capital unless they align themselves on the US monetary policy.
- EME central banks are inclined to pile up additional reserves, resisting appreciation of their currency and reinjecting their dollar reserves in the international capital markets, creating a multiplier effect and driving further down interests rates.
- This excess of liquidity already contributed to the genesis of the Great Financial Crisis (GFC) of 2008-2009. The excess of liquidity is now massively compounded by the QE policies pursued since 2010. This contributed to a massive increase in indebtedness.

Financial globalization with capital flows going in the wrong direction

- Financial liberalization and floating exchange rates have not solved the Triffin dilemma but led to capital movements flowing in the wrong direction for sustainable development. Speculation on short term assets is absorbing the savings of EMEs.
- The system is profoundly inequitable : the search for safe assets in dollars to build up central bank reserves makes capital flow from poor to rich countries, or from countries where Q.E. would be too risky in terms of inflation to countries that can afford it with no danger. Furthermore the dollar denominated reserves invested in US dollar bonds offer only a modest return.
- Financial liberalization and globalization have been based on the unfounded belief in the efficiency of financial markets: financial markets are inherently unstable as the behaviour of financial operators on the supply and demand side for financial assets are not independent but linked through mimetic competition in their assessment of liquidity conditions, which tends to be self-fulfilling (Minsky and Aglietta). This generates a succession of euphoria and panic as a result of subjective common perceptions of liquidity.
- In capital markets, the function of savings mobilization to finance long term credit and investment is superseded by speculative activities, which, although procyclical and unstable, are much more profitable and attract often the best and the brightest at the expense of activities in the real economy. Keynes' Chapter 12 of the General Theory on the spirit of enterprise versus the spirit of speculation is still relevant.
- How , under such circumtances, could we mobilize the huge capital flows needed to finance the long term investments aimed at environmental transition, which have a social return exceeding their private return?



New blind spots in financial regulation and supervision

Although regulation and supervision of banking activities have been strenthened since the GFC, new vulnerabilities have emerged, particularly due to the increasing and often opaque part of intermediation taking place through non bank entities (see recent collapse of Archegos Hedge Fund) as well as the importance of dollar borrowings of non bank entities in emerging markets countries.

The dollar business of non-banks outside the United States is now far higher than before the GFC, raising concern about their inadequate foreign currency liquidity ratios and their fragile dollar funding (in the absence of a dollar lender of last resort).

Currency mismatches and leverage in the private sector have increased.

As a percentage of global GDP, bond credit has now overtaken bank credit.

Greater reliance on international bond markets, through bond funds active in the supply of global credit, has created new, opaque risks (liquidity illusion), which largely escape regulation.

The Result : Global Liquidity Trap in which we find ourselves

- The deflationary effect of the mercantilist policies of the surplus countries and their refusal to pursue expansionary fiscal policies induces central banks to adopt non conventional quantitative easing (QE) policies, which leads to an exponential increase of liquidities.
- However, as a result of large and long term uncertainties and the higher returns of speculation, these liquidities are not achieving their objective of stimulating long term investment in the real economy : they are massively invested in short term instruments, driving further down interest rates and driving up stock exchanges and real estate prices, while the world remains direly short of long term investments, such as those required to fund the environmental transition and attain the SDGs. (Andrew Sheng)
- "The dynamics of the current non system are unsustainable and increasing structural risks, in particular the risk of a global liquidity trap" Mark Carney, former Governor of Bank of England, Jackson Hole Speech of 23 August 2019 . He concluded that we needed « to change the game ».

IMS and Debt Unsustainability is part of a broader unsustainability

- Environmental Unsustainability: climate change, decreasing biodiversity, unsustainable use of non renewable natural resources
- Economic Unsustainability : excessive balance of payments surpluses and deficits, making possible overindebtedness of major Sovereign States, major corporates and financial intermediaries
- Social Unsustainability : increasing inequalities, perception of being of the majority of the population of being left behind (no increase in median as opposed to averaged income)
- Financial Unsustainability : hyperdevelopment of the financial sphere beyond its economic utility, feeding instability
- Political Unsustainability : unsustainable tax competition, unfair distribution of income and wealth leading to an excessive influence of vested interests, State capture, perceived betrayal of the elites, leading to populist threats to democracy and to the values of the « Enlightedment »
- Ideological Unsustainability : need to revise the dominant neo-liberal utilitarian paradigm, un sufficient appreciation of the role of the State and of the importance of public goods that have to be financed through the budget.

A common origin
Market failures and biaised relative prices

- Environmental externalities : e.g. biaised prices for fossile energies, absence of pollution tax, lack of internalization of the « footprint » of economic activities
- Overwhelming short-termism and transfer of debt burden to future generations
- Insufficient supply and inadequate pricing of public goods combined with inadequate taxation of global activities
- Non incorporation in the price system of social costs linked to job insecurity, delocalizations, unemployment, retraining, loss of social cohesion
- Globalization going beyond its optimal level as a result of artificially low transportation costs.
- Systemic instability of financial markets, increasing decoupling of finance and economy, and diversion of human and financial resources to financial activities due to private returns going beyond their contribution to social welfare
- Overly high prices for safe assets in US dollars (correspondingly overly low yields)

Is the prevailing utilitarism the expression of a male bias in decision making, giving preference to the short term?

- Western rationality, based on fragmented analyses and binary belief cultures, has given Western societies, particularly since the industrial revolution, a temporary material superiority, despite an unsustainable impact on the planet. This abusive rationality, crude utilitarism and predatory behaviour (Keynes' « animal spirits »), biaised towards instantaneity, might be explained by male domination in a world of still marked by primitive survival selection.
- Women tend to have a better understanding of the interdependent, holistic and unitary nature of life. The way they analyse problems and seek solutions might be less unidimensional and materialistic and more open to ethical preoccupations. See the feminist Amerindian myth of the « Pachamama ».(Sarah Smyrne and Christian Ghymers)
- Addressing the Gender issue is part of the systemic revolution needed to avoid a civilizational collapse.
- The concept of « noogenesis » invented y the French Paleontologist/Jesuit Pierre Teilhard de Chardin could be a source of inspiration : it refers to the evolutionary process by which a brighter scenario on earth would be possible insofar as humankind could counteract the universal law of entropy in organizing social progress and cooperation on the basis of ethical values.

How would the introduction of a multilateral reserve currency contribute to a more sustainable world?

- Moving from the present dollar system to a multilateral reserve currency, which would not be the debt of any particular country but of the global system, would solve the Triffin dilemma, remove the adverse « built-in destabilizer» and make possible a collegial management of global liquidity as a global public good.
- The basis for such a systemic solution already exists : it is the Special Drawing Right (SDR) created by the IMF in 1969, with the stated objective of becoming the most important official reserve currency. The SDR would need to be transformed into a genuine Multilateral Drawing Right (MDR). At some point, like the ECU becoming the euro, it should stop being a basket of national currencies and become a genuine multilateral currency.
- The IMF should simultaneously become a multilateral central bank, organizing the clearing of international payments above national central banks, and a genuine lender of last resort, issuing the safest asset and influencing global liquidity through purchases or withdrawal of eligible national bonds.
- This should allow each central bank to pursue the monetary policy best suited to its particular situation, without concern for spillovers or spillbacks. The increase of safe assets denominated in MDRs should facilitate a corresponding decease in QE by the major national central banks.
- Global liquidity management should also facilitate a managed decrease of the financial sphere and a reorientation of incentives towards the financing of SDGs and of the environmental transition.

A sequenced agenda to achieve this first best solution

Such an agenda was already outlined in the Report of the Palais Royal Initiative and spelled out more in detail by Michel Camdessus and Anoop Singh in a report prepared under EMF auspices in 2014. It includes three steps :

1. Overdue IMF reforms, already proposed in the Palais Royal report

2. Introduction of a reliable mechanism for calibrating global liquidity in function of global needs

3. A new Bretton Woods : transforming the IMF into a full-fledged global monetary institution

Overdue IMF Reforms

- Reinforcing the IMF's surveillance function, making it more effective and more equitable, developing indicative guidelines of acceptable imbalances, broadening the surveillance on capital movements and capital accounts balances and developing a statutory mechanism for sovereign debt resolution, among others through the introduction of collective action clauses (CACs) in the issuance of sovereign bonds on international capital markets.
- Mitigating large swings in exchange rates among major currencies and addressing cases of serious misalignment: making countries' obligations of exchange rate policies more specific, through the use of benchmarks based on macroeconomic fundamentals;
- Strengthening the IMF's legitimacy and governance: adjusting quotas and voting rights to reflect the increasing importance of emerging countries and reforming decision making, entrusting final decision-making power to a Ministerial Council or to the existing IMF's International Monetary and Financial Committee (IMFC), comprising ministers and central bank governors, rather than the present Executive Board of senior officials.
- Reforming the make up of the G20, restructuring it along the lines of the IMFC, based on the 24 Bretton Woods constituencies, to ensure that the full membership of the IMF is retresented.

A mechanism to regulate global liquidity

- Michel Camdessus and Anoop Singh proposed in 2015 the creation of a high level group of central bank governors (the governors of the central banks whose currencies are included in the SDR currency basket) , who would periodically submit to the IMFC a report on global liquidity and measures for calibrating global liquidity.
- Restoring the potential of the SDR by ensuring that the managers of the system have the power to use it much more flexibly and as needed by the global liquidity situation: SDRs should be promptly issued if needed and, just as rapidly, mopped up to stabilize global liquidity situation.
- More specifically, follow suggestions of RTI Working Party on the SDR of 2014 : reform of irrational present regime of allocations, based on quotas and change anachronic denomination, build the SDR competitiveness by developing use for both official and private payments and bond issues. SDR bonds should become the world preferred safe assets.

The long term need for a systemic reform eliminating the Triffin dilemma

- Doing worldwide what was done at national level
- Regulating in a collegial, rational way global liquidity needed for a globalized economy would imply the creation of a single global currency issued by a single multilateral central bank, as Keynes proposed in Bretton Woods. We need a new Bretton Woods for managing global liquidities.
- The best solution would be to create a multilateral reserve currency (e.g. Multilateral Drawing Rights), issued by an IMF transformed into a global central bank, in other words a liquid liability that is not the debt of any individual country.
- This first best solution seems today out of reach because political forces, voting, decision making processes and regulations remain mostly national (to some extent regional in the case of the EU), while economic and financial developments are global.

Second best solutions compatible with existing constraints

- Making the best out of the current system.
- Drawing attention to vulnerabilities in international capital markets and « blind spots » in the current regulatory and supervisory framework.
- Moving explicitly in the direction of a multipolar world : enhancing the international role of the euro, as recommended by the European Commission, and anticipating on a future important role of the renmimbi. However, there is no guarantee that the relationship between these currencies would be stable. Could we avoid a « currency war »? Would it not be preferable to move directly to an SDR based world?
- Using the SDR as a lever to reform the IMS towards a more balanced and representative way for managing rationally global liquidity creation: follow the recommendations of the RTI Working Party on the SDR. Look also for opportunities created by Central Bank Digital Currencies (CBCD) to facilitate interoperability and therefore the creation of a digital SDR , crossing the border beween Official and private SDR.
- Making international public opinion more aware of the ongoing risks of instability inherent in the current system leading possibly to a new, large-scale crisis. « Never waste a good crisis ».
- Getting the support of the US for this transformation is essential. The decisions taken by President Jo Biden in his 100 first days do not exclude that the US might move in the right direction.

The COVID crisis : a window of opportunity for reform

- We could observe that, in the early months of the crisis, the Fed Reserve behaved as the *de facto* LLR in a dollarized world extending generously swaps to central banks, including central banks of EME countries, heavily indebted in dollars and exposed to a dollar credit crunch. This showed the magnitude of the risks incurred by the Fed in playing this role and also the politicisation involved : e.g. exclusion of China or Iran. Would it not be preferable to give this role to the IMF?
- This would require a substantial increase in the IMF « firepower », currently estimated at 1 trillion dollar. The G20 appears open to a significant increase of the IMF resources.
- Let us maximize what can be done on the basis of the dollar 650 billion SDR allocation decided at the G20 2021 Spring Meeting, in particular setting up a Trust Fund, under IMF auspices, allowing countries, which do not need additional reserves to onlend their SDRs to countries in difficulty.
- The Chinese leadership has given renewed signals of support for a more substantive role of the SDR: let us engage the dialog.
- Getting a multiplier effect in allowing Regional Safety Net Institutions (e.g. the Asian Chiang Mai Safety Net or the proposed African Monetary Fund, that would underpin the African Continental Free Trade Association) to be Prescibed Holders of SDRs and to borrow from this Trust Fund.
- A successful use of the 2021 SDR allocation would familiarize the international community with this instrument and pave the way for more frequent and substantial SDR allocations

Thank you for your attention

More information on RTI activities and publications can be found on

www.triffininternational.eu